MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades $6.8 billion Puerto Rico Senior Sales Tax Revenue Bonds to A2 from Aa3 and affirms $9.2 billion subordinate bonds at A3

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Outlook changed to negative

New York, October 03, 2013 -- Moody's Investors Service has downgraded to A2 the Puerto Rico Sales Tax Financing Corporation's (COFINA) outstanding senior sales tax revenue bonds and affirmed the A3 on COFINA's outstanding subordinate sales tax revenue bonds. The outlook for both has changed to negative from stable. Moody's also affirmed the general obligation (GO) rating of the Commonwealth of Puerto Rico at Baa3. Ratings that are based on or capped at the GO rating of the commonwealth were also affirmed. The GO outlook is negative.

SUMMARY RATING RATIONALE

The downgrade of the COFINA senior lien bonds reflects the following key drivers:

- Persistent and cumulative effects of the weak economy of the Commonwealth of Puerto Rico (GO, Baa3, negative) has significantly constrained growth in sales tax revenues. While the commonwealth took extraordinary measures in the last several months to stabilize its fiscal situation, economic recovery prospects remain weak.

- Our reassessment of the close and enduring linkages that exist between the commonwealth's fundamental credit position and that of the sales tax bonds, leading us to conclude that the prior six rating notch differential from the GO rating was too great.

Our Special Tax Methodology recognizes strong linkages between a government's GO and special tax ratings and notes that special tax ratings rarely exceed GO ratings and, in cases where they do, usually by not more than two notches. At four notches between the GO and the senior lien, our view of the legal separation between the credits remains strong.

We also note that steeply escalating debt service schedules will require significant sales tax revenue growth in order to maintain coverage levels consistent with current ratings, even with the addition of new revenues from the recently legislated sales tax expansion.

The COFINA ratings also reflect strong bond security provisions that include the first right to certain sales taxes collected in the Commonwealth of Puerto Rico, a collection mechanism that separates those monies from the General Fund, a non-impairment covenant by the commonwealth and an effectively closed senior lien.

The negative outlook on the COFINA bonds reflects the negative outlook on the commonwealth, and the expectation that COFINA's rating would go down if the commonwealth's rating were to go down.

STRENGTHS

* A strong legal structure, including a pledge of the larger of either 2.75% of the first dollars collected of the commonwealth's 7% sales tax or a minimum, fixed Base Amount, and a collection mechanism that segregates those monies from the General Fund.

* A broad and diversified economic base that supports the sales tax pledge, including many products and services, but excluding the more volatile sectors of automobiles and energy, and strong long-term growth of personal consumption expenditures.

* Non-impairment covenant by the commonwealth; legal opinions that the pledged sales tax revenues are not available to its General Fund.

* Strong annual debt service coverage on first-lien bonds.

CHALLENGES

* Escalating debt service structure requires growth in revenues to meet debt service on the subordinate bonds in the future.

* Coverage could fall if growth in the sales tax is less than expected, or depth and duration of the commonwealth's recession is greater than expected.

* Increasing pressure on the insularity of sales and use tax revenues due to ongoing weakness in the Commonwealth's economy and finances.

* Although the legislature recently expanded the sales tax base, the legislature could change the sales tax in a manner that decreases available sales tax collections, although significant non-impairment protections for bondholders have been put in place.

* Collection rates have historically been estimated at around 60% (although enforcement has recently improved considerably and additional enforcement measures are currently being implemented).

* Long maturities (senior bonds have 45-year final maturity).

Outlook

The rating outlook for the Sales Tax Revenue Bonds is negative. The negative outlook on the COFINA credit reflects the negative outlook on the commonwealth, and the expectation that COFINA's rating would go down if the commonwealth's rating were to go down.

WHAT COULD MAKE THE RATING GO UP

-Improvement in the general obligation rating of the Commonwealth of Puerto Rico

-Significant increase in the growth rate in sales tax revenues, leading to a significant increase in coverage

-Increase in the sales tax rate without increasing ability to issue bonds under existing liens

-Increase in a portion of sales tax dedicated to the bonds without increasing ability to leverage

WHAT COULD MAKE THE RATING GO DOWN

-Decline in sales tax revenues, leading to decreased coverage

-Deterioration in the general obligation rating of the Commonwealth of Puerto Rico

RATING METHODOLOGY

The principal methodology used in this rating was US Public Finance Special Tax Methodology published in March 2012. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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